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OFFICE OF REPORTS AND ESTIMATES, CIA  
FAR EAST/PACIFIC BRANCH

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26 JANUARY - 1 FEBRUARY 1949

SECTION I. SUMMARY OF FAR EAST TRENDS AND DEVELOPMENTS

Financial circles in Malaya are voicing complaints over the small proportion of Japanese imports earmarked for that area under the new Japan-sterling bloc trade agreement (page 2).

MATSUKOTO, head of Japan's "Outcast" class has been purged, an act which may allow Communist exploitation of these million-odd socially stigmatized Japanese (page 2).

The mid-January uprising in North Korea (Intelligence Highlight No. 34) appears to have taken place and been promptly put down (page 3).

This week the Chinese Nationalist High Command laid plans for a new defense line to be set up south of the Yangtze river (page 3). The principal bureaus and Ministries of the National Government announced their removal to Canton (page 4). Native Taiwan leaders warned US officials of a coming revolt on the island as economic conditions there worsened (page 4). The Chinese Communist Party increased its demands on Li Tsung-jen's Government and outlined its plans for a zonal peace throughout Nationalist China (page 6). CHANG Chih-chung departed for Tientsin reportedly to negotiate a USSR-Sinkiang trade pact (page 5).

The Karen-Burman conflict, which has spread throughout Lower Burma, appears now to have reached the pitch of full-scale race warfare (page 7).

Reaction in Indochina to the current negotiations between the French Government and the former Annamite emperor Bao Dai in Paris has ranged from indifference to hostility (page 7).

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The marginal notations used in succeeding sections of this Weekly ("A", "B" or "C") indicate the importance of the items in B/PS opinion with "A" representing the most important.

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## SECTION II. DEVELOPMENTS IN SPECIFIED AREAS

### GENERAL

#### Malaya wants more trade with Japan

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Disappointment in Malaya's share of the trade arising out of recent agreement between Japan and certain parts of the sterling area has been voiced by the financial editor of The Straits Times. The financial editor believes Malaya is being discriminated against, because it can import only a small part of the cheap Japanese goods which it needs to lower its high cost of living. In return, its exports to Japan are of such volume that, in addition to building up the British Empire dollar pool, Malaya will be furnishing sterling or its equivalent in goods with which the rest of the Empire may purchase cheap Japanese goods.

Already, restrictions are being placed on Malayan imports from Japan. During the month, when operations commenced, Malayan importers sought permits for over \$11,500,000 worth of goods--monosodium glutamate, agar-agar, canned sardines, cuttlefish, clocks, glassware, canvas shoes, menthol crystals, porcelain ware, and toys. To date, no permits have been issued.

Japan will procure much-needed commodities from Malaya--rubber, tin, sago flour, iron ore, coconut oil, and other Straits produce. During the first month of the agreement, Japan had bought \$9 million worth of such commodities, mainly rubber and sago flour. Before the war, Japan was the largest Far Eastern market for Malaya's rubber and tin and took all of Malaya's iron ore and manganese ore. Japan's chief export in return was cotton piece-goods. During the past two years, US cotton goods dominated Malaya's markets. If, under the new sterling area agreement, a large part of the textile quota is allocated to Japan, US exporters may be expected to complain.

### JAPAN

Purge of "Outcast" leader. On 24 January the Attorney General's office announced the purge of MATSUMOTO Jiichiro, Vice President of the Japanese Diet's upper house, on the grounds that he was an executive member of the Daiwa National Service Movement Headquarters, a wartime nationalist society. MATSUMOTO, a leader of the left-wing clique of the Socialist Party and one of the party's four advisers, is the unquestioned head of the Eta or "Outcast" class in Japanese society, a class estimated by the Japanese Government to number one million and by their own leaders as three million. It is anticipated that the purge will have wide political repercussions.

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Announcement of the action was obviously delayed until after the 1949 general elections. No official explanation has been given for the failure to purge MATSUMOTO prior to the 1947 general elections, in which he received the second largest number of votes received by any candidate for the House of Councillors, the Diet's Upper House.

The socially and economically stigmatized Eta "Outcasts" should be "naturals" for Communist equalitarian propaganda but JCP efforts have been without evident success to date. In the 1947 elections, for example, the Eta class supported the Socialists, due to MATSUMOTO's leadership. With MATSUMOTO purged, the Communists may succeed in guiding the political activities of the Eta group in the future.

#### KOREA

North Korea uprising quelled in early stages. Reports indicate that an uprising began on 19 January 1949 and continued through 22 January in Haeju, a west coast port town located just north of the 38th parallel. Early enthusiastic statements by officials of the Republic of Korea told of large fires and shooting. Radio Pyongyang announced arrest of terrorists sent to Haeju from South Korea, with instructions to attempt an uprising, thus substantiating the fact that some disturbance had occurred in the city. It is now accepted that rioting of local nature, which failed to achieve any measure of momentum, broke out in Haeju but was quickly brought under control by authorities of the puppet Democratic People's Republic. Although South Korea's Premier, Lee Bum Suk, has categorically denied any complicity in the attempt to engineer uprisings in the North, [REDACTED] indicate that some Republican Government personnel were involved in the abortive Haeju riot.

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#### CHINA

Nationalist plan "new" defense line. As the Chinese Communist armies continued to move into position along the north bank of the Yangtze from Wuhu to the Grand Canal, the Nationalist High Command in Nanking started withdrawing troops southward from its "impregnable" Yangtze defense line and is now preparing a new position along a general west to east line running Wuchang-Nanchang-Chientang River. This defense plan reportedly to be implemented if current peace negotiations fail, will result in the complete abandonment of Shanghai, Nanking and Hankow. It is therefore anticipated that these cities will come under Communist control within the next 30 days.

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This latest defensive tactic appears to be a Nationalist stall for time, allowing the Government to preserve its remaining men and equipment, to avoid any further "shooting-war" and to await the possible renewal of US aid. The withdrawal probably sets the stage for the next act in China's

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civil war extravaganza--"The War of Movement." The Nationalist forces will probably make a series of "strategic withdrawals" through such "paper" defense zones, which will be "vigorously defended" until the Communist Armies approach them.

National Government Moves to Canton. The Communist military threat to Nanking and the deadlock in peace negotiations have resulted in removal of the Nationalist capital to Canton, where the Government has announced it will be open for business in its new location on 5 February. Although the transfer is relatively complete (with some Government units going to Taiwan, Foochow and other points) so that few Government resources will be left in Nanking for the Communists, abandonment of that city is a heavy blow to Nationalist prestige. In the lower Yangtze, the National Government gives up its political stronghold of the past two decades and departs for an area where local political elements are largely unfriendly or strongly antagonistic. The western powers' decision to keep their ambassadors in Nanking, at least for the immediate future, which suggests the possible future recognition of a Chinese Communist Government, is an added blow to the retreating Nationalists.

LI Tsung-jen loses political support. Besides the various difficulties attending the removal of the Government from Nanking, Acting President LI has been losing political support from both the Right and the Left. His attempted reforms and peace moves have occasioned the resignation of CHEN Li-fu and several other Cabinet members. The other members have all left Nanking for various locales in the south and west. While LI at present remains in Nanking, he will probably depart in the near future for Canton.

While relatively few prominent Nationalist leaders are likely to remain under Communist rule in the Nanking area, the harshness of Communist peace tactics will tend to bring greater unity and cohesion among those Nationalist officials who cannot accept Communist tutelage or make a bargain with the Communists. In maintaining further resistance against Communism, the National Government will continue its efforts to obtain foreign assistance and support, which more than ever will be essential for its survival.

Native Leaders warn of coming uprising in Taiwan. Exiled leaders of the Formosan League for Re-emancipation have stated that the native underground revolutionary movement may be manifested shortly in an outbreak against the mainland Chinese in Taiwan, despite recent strengthening of National Government forces on the island. Although there is little evidence to suggest that such an uprising would seriously impair the Government's position, popular resentment and frustration may result in acts of violence and sabotage in the next few weeks. Taiwanese leaders are seeking to influence world opinion and especially to gain US good will and support for their anti-Communist, pro-American program of independence from China.

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Meanwhile, the disruption of Taiwan's economy by the influx of governmental and other refugees from the mainland continues. Perhaps as many as a million people have fled to Taiwan and the Governor, Gen. CHEN Cheng, has stated that a million more are expected. The island is already experiencing increased inflation and a shortage of rice and other commodities due to overpopulation. The almost complete diversion of shipping from trade to the evacuation and support of the Government and official families will further depress Taiwan's economy. The "industry" so far shipped to Taiwan is mostly arsenal equipment from Hankow, Nanking and Tsingtao and if put in operation, will only drain Taiwan's limited power and other resources to the detriment of Taiwan's normal industries. Although the presence in Taiwan of extensive Nationalist gold reserves might tend to stabilize the currency, the gold is not there for Taiwan's benefit, but as insurance for the remainder of the Nationalist Government.

Negotiations for renewal of Sinkiang-Soviet trade. CHANG Chih-chung, top official for Northwest China, has left for Tihwa to discuss a trade agreement with the USSR, according to persistent reports from Nanking. Acting President LI Tsung-jen and Premier SUN Fo are said to have okayed such a pact, which would authorize resumption of trade between the USSR and Sinkiang Province, officially suspended since 1943. Such an agreement will doubtless include major economic concessions to the USSR, and is likely to grant privileges similar to those exercised during the SHENG Shih-tsai regime (1933-1944), when Sinkiang was virtually a Soviet satellite state. In return, the Chinese may hope to receive a promise of Soviet mediation in Nationalist-Communist negotiations. "B"

The Chinese have been trying to arrange Sinkiang-Soviet trade negotiations for over two years, but until recently the USSR has consistently stalled them off, perhaps with the idea of extracting greater concessions at a later date. Conclusion of a Nationalist-Soviet agreement on Sinkiang at this juncture would indicate that the USSR desires to preclude Chinese Communist control over an area regarded as strategically vital to the USSR.

CHANG Chih-chung recognizes that a renewal of Sinkiang-Soviet trade is vital to the success of any Sinkiang regime. In view of the collapse of the National Government and the deadlock in bargaining with the Chinese Communists, CHANG may hope to establish a domain for himself in the Northwest by entering into an arrangement with the USSR for sharing the benefits of Sinkiang.

Dissidents endorse Communist program. Recent "declarations" of Marshal LI Chi-shen and other dissidents presently in Communist areas of China strongly have supported current Communist demands, such as uncompromising completion of "the revolution" and liquidation of political organizations outside the Communist fold. Moreover, a recent statement "B"

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identifies SUN Yat-sen's Principle of the People's Livelihood with Communism. Such pronouncements indicate that the dissidents have abandoned completely the traditional liberalism of the Democratic League and other minor groups and have thrown themselves into the arms of the Communist Party. This fact will limit the effectiveness of their efforts to win over non-Communist Chinese to a "coalition" government under Communist leadership. It appears likely the dissidents will lose support of some of their own associates and sympathizers who are unwilling to go into the Communist camp under these circumstances.

Chinese Communists increase demands, map zonal peace. The Chinese "A" Communists this week demanded that realization of MAO Tse-tung's eight points occur before the start of peace "negotiations." Additionally, they called upon Acting President LI Tsung-jen to arrest and deliver to them President CHIANG Kai-shek and all other "war criminals," including Gen. Okamura, onetime commander of Japanese forces in China, whom the Nationalists recently acquitted of war guilt. LI could not possibly comply with these demands in their entirety, even if he wished, and the intransigence of the Communists has led to a general recognition that in effect they demand unconditional surrender.

Communist inflexibility might appear to be a serious political error. A milder policy would have strengthened the Communist claim to be the 'peace party', gained for them the services of some Government leaders and simplified their problem of obtaining international recognition as the legal Government of China. Actually, the Communists have lost little or nothing by their severity. They can and will claim that LI's Government has frustrated peace efforts by running away to Canton, that most Government leaders are "war criminals" for whom there would be no place in a Communist-controlled regime, and that LI, in the absence of CHIANG Kai-shek, has no authority to surrender the 'National Government' to the Communists. The Communists realize, moreover, that the decision of foreign governments to leave their ambassadors in Nanking implies the possibility of eventual de jure recognition of a Communist-controlled government.

There is no single authority, CHIANG Kai-shek included, who can deliver intact to the Communists the remaining anti-Communist forces in China. In this light the Communists quite properly regard the Nanking Government as a mere regional regime, controlling only one or two of the principal centers of resistance. They have announced therefore that the pattern established by the surrender of Peiping--gradual Communist occupation of the city as Nationalist forces withdraw and lay down their arms--will be applicable to 16 other major centers: Nanking, Shanghai and Hangchow in the east, Taiyuan and Sian in the north, Kueisui, Lanchow and Tihua in the northwest, Chengtu and Kunming in the west and southwest, the southern cities of Changsha, Nanchang, Foochow and Canton, and the island of Hainan as well as Taiwan where CHIANG Kai-shek intends to

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make his last stand.

The Peiping formula gives the Communists the double advantage of peaceable occupation of areas of resistance and sufficient time to staff Communist administrations for such areas. The Communists will continue to plan their "coalition" government for all China--excluding CHIANG and his associates but perhaps including those Nationalist leaders who assist the Communists in their occupation of the 16 centers. The "coalition" government, with Peiping as its capital, will probably be proclaimed at some time after the Communists have extended their control over more than half the territory and population of China and will then seek international recognition as the legal Government of China.

#### INDOCHINA

Little faith in Bao Dai plan exhibited. Reaction in Indochina to the current negotiations between the French Government and the former Annamite emperor Bao Dai in Paris has ranged from indifference to hostility. The Vietnamese press in the French-controlled areas has been particularly skeptical and has stressed the disunity among French parties and the divided French attitude towards negotiations with the Vietnamese Government led by Moscow-trained Ho Chi Minh. Some observers excused Bao Dai's hesitation to accept the leadership of a Vietnamese regime without detailed agreements from the French on the grounds that the French Government's division and uncertainty on its Indochinese policy could not inspire confidence. One usually-rightist French editor in Saigon, who reflects the local colonialist viewpoint and who has been vehement in his denunciation of the Bao Dai-Xuan plan to end hostilities, insists that the return of Bao Dai will not solve the Franco-Vietnamese problem, since the ex-emperor will not have sufficient military power to combat the growing strength of the Ho Chi Minh Government. Since this editor predicts eventual failure for a Bao Dai regime, he considers either the use of substantially increased military force or negotiation of the best agreement possible with Ho Chi Minh as the only alternatives. Even French officials in the area, although professing to favor the former emperor's return, believe that Bao Dai cannot immediately end the fighting, a fact which they feel may later have an adverse effect upon public opinion in both France and the United States. This lack of confidence in the Bao Dai plan on the part of both French and Vietnamese in Indochina will hinder the implementation of any treaty which may be signed in the near future.

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#### BURMA

Karen-Burman strife greatly increased. The Karen-Burman conflict,

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BURMA (continued)

which has spread throughout Lower Burma, appears now to have reached the pitch of full-scale race warfare. This increasing strife is by far the most acute problem facing the seriously-weakened Burmese Government. In what seems to be a coordinated plan, the Karens are fighting for possession of several important towns within a radius of 150 miles of Rangoon, including the Port of Bassein. Many Karen and Burman villages have been destroyed and in several cases the inhabitants slaughtered. Burman refugees are streaming into Rangoon, while Karens are fleeing the capital. Karen troops are reportedly deserting the armed forces. They are expected to continue defections as the fighting becomes progressively more vicious.

Although peace talks are now said to be under way between Prime Minister Thakin Nu and Karen leaders, there seems to be no likelihood of a reasonable and lasting settlement between Karens and Burmans in the foreseeable future. Prime Minister Nu, who in the past has been conciliatory, may offer substantial concessions to the Karen insurgents. It seems most unlikely, however, that Nu will grant the paramount Karen demand—formation of an autonomous Karen State which would include areas where Burmans outnumber Karens by as much as 3 to 1.

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SECTION III. DIGEST OF IMPORTANT STUDIES AND ESTIMATES

THE EFFECT OF A COMMUNIST VICTORY IN CHINA UPON INDOCHINA  
(OIR #3480.59, 15 December 1948)

The imminence of a Communist victory in China makes a solution of the military and diplomatic struggle in Indochina more urgent than ever. The Vietnam Government is gradually increasing its military strength relative to the French. Without foreign assistance to either side, the Vietnam Government may force the French to withdraw from all of Tonkin, except Haiphong and the coal ports, by mid-1949, and later from all the Annamese areas. The French have come to a general agreement with Bao Dai that he should return to Indochina as constitutional monarch of an autonomous Vietnam within the French Union. Bao Dai has refused to return without a treaty detailing French-Vietnam relations in all fields. If by some unusual maneuver the French Parliament were to change the status of Cochinchina and sign a treaty granting genuine autonomy to Vietnam through Bao Dai, a necessary part of the treaty would have to be a provision for the severe limitation of French forces in Indochina and restriction on the police and military actions of the French. It seems likely that were Bao Dai to return to Indochina under these conditions, he would find that the only effective military force in Indochina belonged to the Vietnam Republic and he would have to come to terms with that Republic in order to maintain himself in power. Some sort of a coalition government between Bao Dai and Ho-Chi-Minh could therefore be anticipated, and in effect the French would have been coming to terms with Ho.

If the war between Vietnam and France is concluded before the Communists achieve their victory in China, the deep-seated Vietnamese fear of the Chinese should be a powerful influence toward resistance of Chinese Communist penetration. In fact, a Vietnam Government in which Communist influence was not dominant would probably welcome American assistance in an effort to contain the Chinese Communists on the Tonkin border. If, however, the war is still continuing when the Communists consolidate their control in China, the Vietnam Government whatever its political complexion, would accept assistance from the Chinese Communists despite popular fear of the Chinese. Assistance from the Chinese Communists not only would hasten the success of Vietnam in forcing the French to withdraw from Indochina but also would materially strengthen the Communist elements within the Vietnam Government, possibly to the extent that the anti-Communist and anti-Chinese groups now influential in the government would be powerless.

The Ho government is willing to negotiate an agreement with France on the basis of the Accord of March 1946 and the September 1946 modus vivendi and would accept the assistance of a third party or the United Nations in such negotiations. Since it is confident of its military strength, it would not agree to a military truce until convinced that these basic principles have been agreed to in good faith by the French Government. A Vietnamese Government friendly to the West can best be secured through an agreement made directly with Ho-Chi-Minh's government.

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